HOUSE BUDGET COMMITTEE

Democratic Caucus

The Honorable John M. Spratt Jr. ■ Ranking Democratic Member

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July 21, 2004

Inflation and Stagnant Wages Leave Low- and Middle-income Workers Behind

Dear Democratic Colleague:

There is growing evidence that little benefit from Bush Administration economic policies is trickling down to average working Americans. As prices rise for fuel, food, and other necessities, wages remain flat. June data from the Bureau of Labor Statistics shows that average hourly earnings for production and non-managerial workers declined by 1.1 percent between June 2003 and June 2004, after accounting for inflation. I commend to you the attached articles from *The New York Times* and *The Wall Street Journal* , published July 18 and July 20, respectively, which describe the struggle that low-wage and middle-income families face in the current economic environment.

Sincerely,
/s
John M. Spratt, Jr.
Ranking Democratic Member

The New York Times

July 18, 2004

Hourly Pay in U.S. Not Keeping Pace With Price Rises

By EDUARDO PORTER

The amount of money workers receive in their paychecks is failing to keep up with inflation. Though wages should recover if businesses continue to hire, three years of job losses have left a large worker surplus.

"There's too much slack in the labor market to generate any pressure on wage growth," said Jared Bernstein, an economist at the Economic Policy Institute, a liberal research institution based in Washington. "We are going to need a much lower unemployment rate." He noted that at 5.6 percent, the national unemployment rate is still back at the same level as at the end of the recession in November 2001.

Even though the economy has been adding hundreds of thousands of jobs almost every month this year, stagnant wages could put a dent in the prospects for economic growth, some economists say. If incomes continue to lag behind the increase in prices, it may hinder the ability of ordinary workers to spend money at a healthy clip, undermining one of the pillars of the expansion so far.

Declining wages are likely to play a prominent role in the current presidential campaign. Growing employment has lifted President Bush's job approval ratings on the economy of late. According to the latest New York Times/CBS News poll, in mid-July, 42 percent of those polled approved of the president's handling of the economy, up from 38 percent in mid-March.

Yet Senator John Kerry, the likely Democratic presidential nominee, is pointing to lackluster wages as a telling weakness in the administration's economic track record. ``Americans feel squeezed between prices that are rising and incomes that are not," Mark Mellman, a pollster for the campaign, said in a memorandum last month.

On Friday, the Bureau of Labor Statistics reported that hourly earnings of production workers - nonmanagement workers ranging from nurses and teachers to hamburger flippers and assembly-line workers - fell 1.1 percent in June, after accounting for inflation. The June drop, the steepest decline since the depths of recession in mid-1991, came after a 0.8 percent fall in real hourly earnings in May.

Coming on top of a 12-minute drop in the average workweek, the decline in the hourly rate last month cut deeply into workers' pay. In June, production workers took home $525.84 a week, on average. After accounting for inflation, this is about $8 less than they were pocketing last January, and is the lowest level of weekly pay since October 2001.

On its own, the decline in workers' wages is unlikely to derail the recovery. Though they account for some 80 percent of the work force, they contribute much less to spending. Mark M. Zandi, chief economist at Economy.com, a research firm, noted that households in the bottom half of income distribution account for only one-third of consumer spending.

Nonetheless, coming after the bonanza of the second half of the 1990's, the first period of sustained real wage growth since the 1970's, the current slide in earnings is a big blow for the lower middle class. Moreover, the absence of lower income households could also weigh on overall economic growth - putting a lid on the mass market and skewing consumption toward high-end products.

"There's a bit of a dichotomy," said Ethan S. Harris, chief economist at Lehman Brothers. "Joe Six-Pack is under a lot of pressure. He got a lousy raise; he's paying more for gasoline and milk. He's not doing that great. But proprietors' income is up. Profits are up. Home values are up. Middle-income and upper-income people are looking pretty good."

Tales of tight budgets at the bottom are springing up across the country. "I haven't had a salary increase in two years, but the cost of living is going up," said Eric Lambert, 42, a father of three who earns $13 an hour as a security guard at 660 Madison Ave. in Manhattan.

Silvia Vides, 43, who earns $11 an hour in a union job as a housekeeper at the Universal City Sheraton hotel in Los Angeles, said, "Sometimes I don't know how I pay the bills and food and rent." She has cut back on all nonessential expenditures and she is four months behind on payments on $4,000 in credit-card debt.

Their woes are a product of supply and demand for labor. From 1996 through 2000 when employers were hiring hand over fist, real hourly wages of ordinary workers rose by 7.5 percent. Those for leisure and hospitality workers rose 9.6 percent, and retail workers' climbed 8.9 percent. The raises continued even as the economy slipped into recession in 2001 and businesses began to shed workers.

From 2001 to 2003, 2.4 million jobs were eliminated, as businesses sharply reduced their work forces, refusing to hire back even as demand started picking up. Over a million of these jobs have been regained this year.

Yet with the lowest number of people employed as a share of the population since 1994, there is still a plentiful supply of unused laborers looking for jobs.

As the rise in energy prices in the earlier months of this year led to rising inflation, pushing prices in June up 3.2 percent from the same month of last year, the lackluster job market has left workers in a weak position to demand more money.

"Since last November, we've had a pickup in hiring and a pickup in hours worked in virtually all of our businesses," said David Pittaway, a senior managing director at Castle Harlan, an equity investment company that owns everything from Burger King franchises to a shipping company.

But there is clearly still a lot of slack. When Castle Harlan advertised in the newspapers to fill 70 to 80 positions at a Morton's restaurant it opened in early July in White Plains, 600 to 700 people showed up.

Ms. Vides in California ticks off the items of a rising cost of living. She pays $850 a month for a one-bedroom apartment in Panorama City, $25 more a month than last year. The cost of a bus pass rose $10, to $45 a month. The electricity bill is much higher and food costs more. "I've got to do miracles with my salary," she said.

So Ms. Vides said she was outraged that the hotels negotiating a new contract with her union were offering annual raises of 40 cents to 45 cents an hour each year for the next five years. The raise in 2004 would be about 4 percent, just enough to keep up with the 4 percent rise in prices in Los Angeles over the last year. "This is miserly," said Ms. Vides, who said the union wants $1.25 this year and $1.50 next.

Colleen Kareti, president of the Los Angeles hotel employers' council, which represents the hotels, argued that negotiations had not yet gotten down to bargaining over wages. But she pointed out that times are hard for the hotel business, too. "It's been pretty bad for the last three years. We're nowhere near the levels of business where we were in 1998 through 2000," Ms. Kareti said.

Some economists warn that if wages remain depressed for a long time they may end up weighing on the economy. "The recovery will likely continue on despite the travails of lower-income households, but it cannot flourish," Mr. Zandi said.

So far, spending has been fueled mostly by debt, as consumers took advantage of bedrock-low interest rates to whip out their credit cards and refinance their mortgages. But as interest rates rise to keep inflation in check, continued growth in consumer spending will depend more on jobs and wages.

Spending is still holding up, led by strong corporate profits as well as higher salaries and bonuses at the upper end of the income distribution. But the lagging earnings at the bottom end are making for a somewhat lopsided expansion.

The upper echelons of consumer spending, at places like Saks Fifth Avenue, Neiman Marcus and Nordstrom department stores, are reporting gangbuster business. "I'm surprised by how well we've sold high-priced fashion at this stage," said Pete Nordstrom, president of Nordstrom's full-line stores.

But at the other end, sales at stores open at least a year at big-box discounters like Target and Wal-Mart have disappointed, while sales of used cars are declining year over year, government figures show. "We're not seeing the traffic, not even the same volumes of sales calls," said Richard Cooper, a sales manager at Jones Ford in Charleston, S.C.

Wages at the bottom should eventually recover, as businesses continue hiring to meet growing demand. The question is how fast. "As unemployment slides down, more of the benefits of growth should flow to the working class," Mr. Bernstein said. "But not until we reach truly full employment are they likely to see their earnings rise at a level closer to that of productivity."

The Wall Street Journal

So Far, Economic Recovery Tilts
To Highest-Income Americans

They Gain More, Spend More;
With Job Market Rising,
Will Others Feel Rebound?

Mr. Williams Waits for a Raise

By JON E. HILSENRATH and SHOLNN FREEMAN
Staff Reporters of THE WALL STREET JOURNAL
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Joshua Berry and Ricky Williams, both Houstonians, have seen two very different economic recoveries.

Mr. Berry, an entrepreneur, has profited handsomely from the stock market, in the real-estate boom and by selling a business. Mr. Williams, an airline baggage handler, has been waiting since 2001 for a pay raise.

With the U.S. economy expanding and the labor market improving, it isn't clear how well the Democrats' message of a divided America will resonate with voters this fall. But many economists believe the economic recovery has indeed taken two tracks, exemplified by the experiences of these two Texas residents.

Upper-income families, who pay the most in taxes and reaped the largest gains from the tax cuts President Bush championed, drove a surge of consumer spending a year ago that helped to rev up the recovery. Wealthier households also have been big beneficiaries of the stronger stock market, higher corporate profits, bigger dividend payments and the boom in housing.

Lower- and middle-income households have benefited from some of these trends, but not nearly as much. For them, paychecks and day-to-day living expenses have a much bigger effect. Many have been squeezed, with wages under pressure and with gasoline and food prices higher. The resulting two-tier recovery is showing up in vivid detail in the way Americans are spending money.

Hotel revenue was up 11% in the first five months of 2004 at luxury and upscale chains, but up just 3% at economy chains, according to Smith Travel Research, a market-research firm. At the five-star Broadmoor Hotel in Colorado Springs, Colo., $600-a-night lakeside suites are sold out every day through mid-October.

At high-end Bulgari stores, meanwhile, consumers are gobbling up $5,000 Astrale gold and diamond "cocktail" rings made for the right hand, a spokeswoman says. The Italian company's U.S. revenue was up 22% in the first quarter. Neiman Marcus Group Inc., flourishing on sales of pricey items like $500 Manolo Blahnik shoes, had a 13.5% year-over-year sales rise at stores open at least a year.

By contrast, such "same store" sales at Wal-Mart Stores Inc., retailer for the masses, were up just 2.2% in June. Wal-Mart believes higher gasoline costs are pinching its customers. At Payless ShoeSource Inc., which sells items like $10.99 pumps, June same-store sales were 1% below a year earlier.

A similar pattern shows up in cars. Luxury brands like BMW, Cadillac and Lexus saw double-digit U.S. sales increases in June from a year earlier. Sales of lower-tier brands such as Dodge, Pontiac and Mercury either declined or grew in the low single digits.

"To date, the [recovery's] primary beneficiaries have been upper-income households," concludes Dean Maki, a J.P. Morgan Chase (and former Federal Reserve) economist who has studied the ways that changes in wealth affect spending. In research he sent to clients this month, Mr. Maki said, "Two of the main factors supporting spending over the past year, tax cuts and increases in [stock] wealth, have sharply benefited upper income households relative to others."

The good times upper-income Americans are enjoying represent a bounce-back from the hit that many of the wealthiest took after bonus income dried up in 2001 and 2002 and stock options went sour. For example, Wall Street compensation was up 16% in the first quarter from a year earlier, after having fallen from stratospheric levels the three previous years, according to the Securities Industry Association.

Longer-term issues are also at work. Wage and income disparities between the rich and poor have generally been widening for nearly 20 years. In 1980, the top 10% of households in income accounted for 33% of total household income, according to economist Emmanuel Saez at University of California, Berkeley. By 2000, that had risen to 44%. The figures exclude capital gains. Mr. Saez says the concentration of income at the top dropped during the recession but has probably started picking up again.

Some economists believe the gap is driven wider by technological change and by the economy's increasing openness to global competition. Technology rewards skilled workers, and competition has generally punished the unskilled, who are susceptible to the movement of work overseas. Both factors have come into play in recent years as technology-driven productivity surged and the U.S. trade deficit widened.

Meanwhile, the U.S. has seen a big increase in the sheer number of affluent families. In 2002, nearly 16 million U.S. households had annual incomes of more than $100,000, up from a little more than five million 20 years ago, in inflation-adjusted terms.

For a sense of the divide, contrast the recovery experiences of Mr. Berry, a businessman who earns a six-figure income, and Mr. Williams, the baggage handler, who makes around $20 an hour for Southwest Airlines. Both have been shopping this month at the River Oaks Chrysler-Jeep car dealership in Houston.

Mr. Berry, 34 years old, is president of a nurse staffing business called ShiftBay.com. Last year, he and some partners sold a medical-supply business. Mr. Berry says that together they saved more than $100,000 in taxes, thanks to a reduction last year in the federal income-tax rate on long-term capital gains.

Mr. Berry also is in the process of selling his house, which he says has appreciated by almost $100,000 over four years. And he says that while he lost a lot of money in the stock-market downturn that began four years ago, he has enjoyed hefty gains since the market turned up about 15 months ago. Mr. Berry is choosing between sticking with Chrysler (he now drives a Jeep Grand Cherokee) or trading up to a Cadillac, BMW or Mercedes-Benz.

Mr. Williams, 52, hasn't benefited from the boom in the price of houses because he doesn't own one. His pay hasn't budged since 2001, although he is expecting a raise this month. Within a year, he expects his hourly pay to rise to about $24.

Mr. Williams's car lease (he, too, drives a Grand Cherokee) will be up in October, and he has been scrambling to come up with a down payment for a new Chrysler PT Cruiser. He was still $1,800 short last week. A Chrysler salesman was able to make up part of the difference with an additional $1,000 rebate targeted at returning lease customers, on top of $4,000 in manufacturer's incentives already on the table.

"With the economy the way it is, I've had to rob Peter to pay Paul, and then sometimes rob them both," Mr. Williams says.

The perception of a fast-lane/slow-lane recovery has become a central political issue. This year's stronger job market has led Democrats to shift their emphasis: away from the argument that Bush policies have failed to produce jobs and toward the idea that the expansion's fruits haven't been widely shared.

"They're telling people this is the best economy we've had," Sen. John Kerry mockingly told a riverbank crowd last Thursday evening in Charleston, W.Va., drawing jeers. "What does it mean when you don't have any health care at all?" Hands started popping up throughout the audience, as Mr. Kerry paused to point to each one. "Too many people in Washington have no sense at all about what's happening," he said. His running mate, Sen. John Edwards, speaks of "Two Americas," one "that does the work, another America that reaps the rewards."

Bush critics have argued that the economy is producing jobs mainly in low-paying industries like restaurants and temporary work. Mr. Bush counters that his opponents have been pessimistically distorting the economic statistics, ignoring the gains. The Bush campaign cites data from the Bureau of Labor Statistics showing that in the past year, there has been more net employment growth in occupations with above-average pay than in occupations with below-average pay.

Campaigning in Wisconsin last week, Mr. Bush spoke of a local family of six who benefited from elements of his tax package aimed at lower- and middle-income families, such as the child tax credit. "Oh, some of the sophisticates will say that $2,700 doesn't matter to the Muellers: 'It doesn't sound like a lot to me,' " Mr. Bush said. "It is a lot to them. That's what counts."

Polls suggest that Americans aren't giving the president full credit for an economic recovery, and the class divide in this recovery may help explain that. A Wall Street Journal/NBC News poll in late June found that 45% of Americans approved of his handling of the economy, while 49% didn't.

Mr. Maki of J.P. Morgan Chase estimates that in terms of dollars saved, the top 20% of households by income got 77% of the benefit of the 2003 tax cuts, and roughly 50% of the 2001 tax cuts. And of stocks held by households, roughly 75% are owned by the top 20% of those households. That made them prime beneficiaries of last year's stock-market rally, although also big sufferers from the stock carnage from 2000 to 2002.

The affluent also benefit more from stock dividends, on which the federal income-tax rate was cut last year retroactive to the start of 2003. Total dividend payments have risen 11% to $3 billion since the end of 2002, estimates Berkeley's Mr. Saez. Higher-income households also are larger beneficiaries of the surge in corporate earnings, which helps to drive dividend and stock returns. The level of corporate profits has risen 42% since the last recession, which ended in the final quarter of 2001. Wage and salary income is up just 6.3% in that time. Meanwhile, housing values have appreciated fastest in the most affluent regions during the past three years, according to research by Fiserv CSW Inc., which tracks home prices.

Many economists say the lopsided recovery is now at a critical juncture. The impetus from new tax cuts has largely passed, and the stock market has lost momentum, two factors that could slow the pace of higher-income people's spending in the months ahead. As a result, the time has come for the recovery either to broaden out to more-modest income groups -- or possibly lose momentum.

The late 1990s showed that lower-wage workers benefit when unemployment falls, as the tighter labor market helps underpin wages across income categories. With the job market improving, there is a chance this could happen again, but the outlook is still highly uncertain. Payroll employment has increased by 1.5 million since last August. And some companies that cater to the mass market say they have noticed the turnaround. "We had a terrific Fourth of July weekend," says Wayne Wielgus, a senior vice president at Choice Hotels International Inc., which serves low- and middle-income travelers with brands like EconoLodge and Comfort Inn.

But some economists worry that the early stage of the recovery for low- to middle-income families is being squeezed by continuing pressure on wages and purchasing power. Average hourly earnings have risen at just a 1.9% annual rate since the job market started improving notably last August. Meanwhile, the consumer-price index -- driven by higher food and gasoline prices -- has risen at a 3.3% annual pace. The average worker's purchasing power, in other words, has declined even as more people have been finding jobs since August.

Weekly earnings for production workers and nonsupervisors at service companies, adjusted for inflation, were down 2.6% in June from a year earlier. This slip might be transitory, and it wasn't anywhere near the drops of 5% to 7.5% registered in the late 1970s and early 1980s. Still, it was the largest decline since 1991, and it is a shift from the late 1990s and even the 2001 recession, when real wages were increasing.

As a result, after rising last year, the University of Michigan's consumer confidence index for lower-income households is off 12% so far this year. Confidence among the affluent is lower as well, but by a smaller 6.7%.

The recovering job market and an easing of food- and gasoline-price increases could reverse some of today's pressures. But these aren't the only issues hanging over lower-income households. Many are also highly exposed to rising interest rates, says Mark Zandi, chief economist at Economy.com, because these households were more likely to take out adjustable-rate mortgages to squeeze into an ever-pricier housing market. For those who don't own homes, the chances of buying have become more remote as house prices have soared. "Lower- and middle-income groups are going to remain under significant pressure," Mr. Zandi says.

Many in this group are also getting squeezed as health-care costs rise and companies seek to shift the burden to workers. From 2000 to 2003, employees' average annual out-of-pocket expenses for family medical premiums rose 49% to $2,412, according to an employer survey by Kaiser Family Foundation, a nonprofit research group in Menlo Park, Calif.

Becky Salas, a 32-year-old vocational nurse in San Antonio, says her family is still pinching pennies, even though she believes an economic recovery is taking hold now. Two years ago, she and her husband stopped using credit cards. Expensive toys for her children, movies at theaters and meals at McDonald's also are out. "Easily we could spend $20 at McDonald's for just one meal," Ms. Salas says. And "we can go fly a kite, instead of going to an expensive theater where the kids are going to yell and scream and won't enjoy it anyway."